

Message Text

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AMEMBASSY LONDON
AMEMBASSY ROME
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PASS FEDERAL RESERVE AND COMMERCE

E. O. 11652: GDS
TAGS: EFIN, FR
SUBJECT: FORECAST OF THE FRENCH ECONOMY
FOR 1978 AND FIRST HALF 1979

REFTELS: (A) PARIS 10710, DATED 3/3L/78; (B) PARIS 25252,
DATED 8/31/77; (C) PARIS 01154, DATED 1/13/78;
(D) PARIS 1748, DATED 1/19/78; (E) PARIS 1U140,
DATED 3/24/78

FOR BONN, PASS HERMBERG; FOR LONDON, PASS AMMERMAN,
FOR ROME, PASS DEFALCO; FOR TOKYO, PASS MCCAMEY

1. SUMMARY:

THE BASIC CONSTRAINTS OF THE BALANCE OF PAYMENTS AND
INFLATION CITED IN REFTEL (A) REMAIN VERY IMPORTANT
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CONSIDERATIONS. GOF ECONOMIC POLICY STRONGLY SUGGESTS
THAT THE GOF IS WILLING TO ACCEPT WHATEVER GROWTH RATE
THE ECONOMY CAN GENERATE ON ITS OWN STEAM DURING A
PERIOD OF "LIBERALIZATION" OF THE ECONOMIC SYSTEM.
RECENT TRENDS STRONGLY SUGGEST ONLY A VERY MODEST
PICKUP IN THE OVERALL LEVEL OF ECONOMIC ACTIVITY SO
FAR THIS YEAR. NEITHER MONETARY NOR FISCAL POLICY

IS POSITIONED TO STIMULATE THE ECONOMY. THE LIBERALIZATION OF THE ECONOMIC SYSTEM WILL PUSH THE CPI TO A 10 OR POSSIBLY 11 PERCENT INCREASE THIS YEAR, EVEN THOUGH THE UNDERLYING FACTORS CAUSING INFLATION PROBABLY WILL BE SUBSTANTIALLY IMPROVED. THE POLICY AIM IS A SLOWER RATE OF PRICE INCREASE AFTER OCTOBER WITH A SOLID IMPROVEMENT BEGINNING IN 1979. THE ECONOMIC GROWTH RATE THIS YEAR PROBABLY WILL BE A "SOFT" 3 PERCENT WHICH WILL ENABLE CONTINUED IMPROVEMENT IN THE BALANCE OF PAYMENTS BUT AT THE PRICE OF AN INCREASE IN UNEMPLOYMENT. THE SOCIAL AND POLITICAL RISKS IN THE GOF PROGRAM ARE OBVIOUS AND COULD COME TO A HEAD AT ALMOST ANYTIME. BUT, IF ALL GOES WELL, THE FRENCH ECONOMY COULD ENTER 1979 IN A MUCH IMPROVED POSITION, CAPABLE OF SUSTAINING A HIGHER GROWTH RATE WITHOUT SUFFERING THE BALANCE OF PAYMENTS AND INFLATION CONSTRAINTS THAT HAVE PLAGUED THE FRENCH ECONOMY SINCE 1973. A MORE COMPETITIVE AND STABLE ECONOMY IS CLEARLY BARRE'S OBJECTIVE. IT IS AN AMBITIOUS ONE IN A COUNTRY MUCH MORE ACCUSTOMED TO A KIND OF PATERNALISTIC DIRIGISME THAN TO POLICIES BASED ON MARKET FORCES.

END SUMMARY

2. ASSUMPTIONS

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- (A) GLOBAL DEMAND BETWEEN A 5 AND 6 PERCENT ANNUAL GROWTH RATE;
- (B) AN OIL PRICE INCREASE OF NO MORE THAN 5 PERCENT BETWEEN NOW AND THE END OF 1978;
- (C) FRENCH FRANC/DOLLAR EXCHANGE RATE WITHIN RANGE OF 4.50 TO 4.90 DURING 1978.
- (D) NO BASIC CHANGE IN FISCAL AND MONETARY POLICY FROM THAT CURRENTLY IN PLACE;
- (E) AN INCREASE IN SOCIAL TRANSFER PAYMENTS TO BENEFIT LOW INCOME WORKERS, EMPLOYMENT OF YOUTH, AND OLD AGE WELFARE, ALONG WITH A WAGE POLICY WHICH ACCEPTS A REAL WAGE INCREASE OF BETWEEN 2 AND 3 PERCENT FOR SALARIED WORKERS. THIS POLICY WILL PUSH THE FISCAL PARAMETERS OF THE 1978 BUDGET AND PROBABLY WILL REQUIRE A SOMEWHAT

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LARGER SUPPLEMENTARY BUDGET NEXT SEPTEMBER THAN IMPLIED
IN THE ORIGINAL BUDGET PRESENTATION. THE IMPLICIT
INCREASE IN TREASURY DEBT OPERATIONS AS A RESULT OF
THESE ACTIONS PROBABLY CAN BE FINANCED WITHIN OR CLOSE
TO THE MONETARY TARGET OF 12 PERCENT GROWTH BECAUSE
NEITHER HOUSEHOLD NOR BUSINESS INVESTMENT OVERALL WILL
BE SUCH AS TO SQUEEZE CREDIT, AT LEAST UNTIL THE LAST
QUARTER OF 1978.

(F) NO SERIOUS POLITICAL OR SOCIAL PRESSURES.

(G) A YEAR-OVER-YEAR CPI INCREASE OF ABOUT 10 PERCENT.

NOTE: IF THE ABOVE ASSUMPTIONS CHANGE SUFFICIENTLY
TO ALTER THE BASIC ENVIRONMENT OF THE FRENCH
ECONOMY, A REVISED FORECAST WILL BE SUBMITTED.

3. FORECAST OF THE FRENCH ECONOMY FOR 1978

AND FIRST HALF 1979

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ANNUAL RATES OF GROWTH

FORECAST	FORECAST
1978	1ST HALF
	1979
(ANNUAL BASIS)	

CONSUMPTION	3.2	4.0
PUBLIC CONSUMPTION	4.8	4.8
TOTAL INVESTMENT	0.8	3.0
EXPORTS	7.2	7.2
IMPORTS	6.3	6.8
GDP, EX STOCKS	2.7	3.8
ADJUSTMENT FOR STOCKS		
AS PERCENTAGE OF GDP	0.3	
GDP GROWTH RATE	3.0	

NOTE: STOCK CHANGES IN 1979 PROBABLY COULD CAUSE
THE GROWTH RATE TO BE 4 PERCENT.

4. ESTIMATIONS OF SEASONALLY ADJUSTED ANNUAL REAL
GROWTH RATES BY QUARTER IN 1978 AND FIRST HALF 1979

1ST QTR 2ND QTR 3RD QTR 4TH QTR

1978	0.5	0.7	0.9	0.9
1979	1.0	0.9		

5. BALANCE OF PAYMENTS FORECAST FOR 1978
AND FIRST HALF OF 1979:

1978 1ST HALF 1979

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BILLIONS OF FRANCS

TRADE BALANCE	MINUS 3	MINUS 2.5
NET SERVICES	PLUS 8	PLUS 4.0
NET TRANSFERS	MINUS 10	MINUS 5.0
CURRENT ACCOUNT	MINUS 5	MINUS 3.5

THE BALANCE OF PAYMENTS IN 1978 WILL BENEFIT FROM A
RELATIVE SLOWER GROWTH RATE AND A GREATER WILLINGNESS
BY FRENCH INDUSTRY TO COMPETE IN ITS HOME MARKET AS
THE RESULT OF CHANGES IN PRICE POLICY. THE SWINGS
IN THE FRENCH EXTERNAL POSITION SINCE 1974 HAVE BEEN
ON THE IMPORT SIDE WITH A SHORT-TERM PROPENSITY TO
IMPORT OF ABOUT 4 TO 1 TO INCREASES IN FINAL DEMAND.
A MAJOR CAUSE OF THIS HAS BEEN THE UNWILLINGNESS OF
FRENCH FIRMS TO ADD TO OVERHEAD COSTS IN ORDER TO

INCREASE SALES. THE NEW PRICE POLICY EMPHASIZING GREATER FLEXIBILITY AND RELIANCE ON MARKET FORCES SHOULD CASE THIS PATTERN TO CHANGE TO THE BENEFIT OF THE BALANCE OF PAYMENTS. AT A GROWTH RATE AT OR BELOW 3 PERCENT, FRENCH IMPORTS DO NOT RISE VERY MUCH IN RELATION TO INCREASES IN GNP. WITH THE GROWTH RATE AT OR ABOVE 4 PERCENT, IMPORTS, AS NOTED, TEND TO RISE VERY SHARPLY. THUS, CONTINUATION OF PRESENT BALANCE OF PAYMENTS TRENDS SEEMS LIKELY IN 1978, ALLOWING ONLY

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FOR SOME MODERATE INCREASE IN IMPORTED PRODUCER INVENTORY WHICH IS REPORTED TO BE AT LOW LEVELS.

6. AS REPORTED IN REFTELS, GOF NATIONAL INCOME DATA IS IN A TRANSITION STAGE. AS OF NOW, WE CANNOT CONSTRUCT ON THE BASIS OF DATA AVAILABLE A 1977 BASE FOR FORECASTING PURPOSES AND WILL NOT BE ABLE TO DO SO UNTIL THE NEW GNP SERIES IS AVAILABLE SOMETIME DURING THE SECOND HALF OF THIS YEAR. SINCE OUR 1977 FORECAST OF A 2.9 PERCENT GROWTH IS IDENTICAL TO REPORTED RESULTS, THE TABLE CONTAINED IN PARA 3 OF REFTEL C HAS BEEN USED TO PRODUCE THE FOLLOWING RESULTS EXPRESSED IN FRENCH FRANCS (1970 PRICES):

1977 PRELIMINARY RESULTS AND 1978 FORECAST,
YEAR TOTALS, BILLIONS OF FRANCS, 1970 PRICES 1/

1977 1978

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TOTAL CONSUMPTION	666.8	690.8
TOTAL INVESTMENT	238.3	240.2
EXPORTS, INCL. SERVICES	216.1	231.7
IMPORTS, INCL. SERVICES	204.2	218.1
NET FOREIGN BALANCE	11.9	13.6
GDP, EX. STOCKS	917.0	944.6
ADJUSTMENT FOR STOCKS	N.A.	2.7
TOTAL GDP	N.A.	947.3

1/ AS EVIDENT IN THE ABOVE TABLE AND IN THE RATES
OF GROWTH TABLE IN PARA 3 ABOVE, CHANGES IN STOCKS
HAVE BEEN TREATED AS A POSITIVE RESIDUAL ITEM
IN ORDER TO PRODUCE THE ESTIMATED 3.0 PERCENT GROWTH
RATE. FRENCH GNP FIGURES CURRENTLY DO NOT INCLUDE
STOCKS, WHICH MUST BE CALCULATED EITHER AS A RESIDUAL
ITEM OR EXCLUDED FROM TOTAL GDP. ALSO AS NOTED
PREVIOUSLY, THE RELATIVE PRICE CHANGES FOR EXPORTS AND
IMPORTS SINCE 1970 MEAN THAT EVEN A FAIRLY LARGE TRADE
SURPLUS IN 1970 PRICES TRANSLATES INTO A DEFICIT WHEN
MEASURED IN CURRENT PRICES. IN VIEW OF THE LACK OF A
SUITABLE BASE FOR 1978, A QUANTITATIVE ESTIMATION OF
FIRST HALF 1979 IS NOT TECHNICALLY FEASIBLE. ESTIMATED
ANNUAL RATES OF GROWTH FOR FIRST HALF 1979 ARE SHOWN IN
PARA 3 ABOVE.

7. COMMENTS ON MAJOR COMPONENTS OF GNP:

(A) CONSUMPTION: SINCE THE GOVT PLANS TO "LIBERALIZE"
THE ECONOMY WITH AN IMPLICIT CPI RISE OF BETWEEN 10 OR
POSSIBLY 11 PERCENT IN 1978 WHILE "MAINTAINING PURCHASING
POWER," CONSUMPTION WILL NOT RISE AS MUCH AS PREDICTED
IN REFTEL (A) UNDER SOMEWHAT DIFFERENT ASSUMPTIONS.
THIS SLOWER GROWTH OF CONSUMPTION WILL HAVE A STRONG
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EFFECT ON INVENTORY CHANGES AND THE EXTERNAL BALANCE
AND INDIRECTLY DELAY SOMEWHAT ANY SIGNIFICANT OVERALL
RISE IN INVESTMENT UNTIL 1979. IN FACT, UNTIL THE

THIRD QUARTER PURCHASING POWER WILL STAGNATE, AT BEST, AND THEN SLIGHTLY EXCEED PRICE INCREASES DURING THE LAST TWO QUARTERS, PARTLY AS THE RESULT OF NEGOTIATED WAGE INCREASES BEINNING IN SEPTEMBER. IN SHORT, BARRE SEEMS TO BE REPLAYING HIS 1977 SCENARIO WHEN THE CARROT OF REAL WAGE INCREASES TOWARD THE END OF THE YEAR BALANCED THE STICK OF LITTLE, IF ANY, INCREASE IN REAL WAGES FOR MOST OF THE YEAR. THIS STRATEGY ALSO IMPLIES A RISE IN PRIVATE CONSUMPTION IN 1979, REFLECTING THE YEAR-END INCREASES IN REAL WAGES.

(B) INVESTMENT: THE GOF WOULD LIKE MORE INVESTMENT BUT IS UNLIKELY TO GET ALL IT WANTS FOR TWO REASONS: FIRST, HOUSAHD INVESTMENT, MAINLY IN HOUSING, ACCOUNTS FOR ABOUT ONE-THIRD OF TOTAL INVESTMENT. IT REMAINS VIRTUALLY AT THE RECESSION LEVELS OF 1974-75 IN VOLUME TERMS AND SEEMS MOST UNLIKELY TO RECOVER THIS YEAR. SECOND, SINCE 1974-75 BUSINESS INVESTMENT HAS BEEN CONCENTRATED INCREASINGLY IN SOME INDUSTRIES, NOTABLY AUTOMOTIVE, DURABLE ELECTRONIC CONSUMER GOODS, HEAVY ELECTRICAL, TELE-COMMUNICATIONS, AND GLASS WHICH HAVE IMPROVED BOTH THEIR CASH FLOW AND THEIR RATE OF PROFIT, WHILE THE REVERSE IS TRUE FOR VIRTUALLY THE REST OF ALL LARGE SCALE FRENCH INDUSTRY. THE SITUATION FOLLOWS A PATTERN SIMILAR TO THAT OF LARGER ENTERPRISES. IN SHORT, IN THESE TERMS THE RICH COMPANIES HAVE BECOME RICHER WHILE THE POOR COMPANIES HAVE BECOME POORER. POOR COMPANIES DON'T INVEST. THEY ADJUST THEIR

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BOOKS. SO THE INCREASE IN INVESTMENT BY FINANCIALLY STRONG COMPANIES, WHICH COULD BE SUBSTANTIAL IN 1978, WILL NOT BE SUFFICIENT TO OFFSET IN TOTAL TERMS THE EFFECT OF LITTLE IF ANY INVESTMENT BY THE REST OF FRENCH FIRMS PLUS THE ALMOST CERTAIN LACK OF ANY SIGNIFICANT INCREASE IN HOUSEHOLD INVESTMENT. IF THE BROAD LINES OF THE BARRE PLAN ARE HELD THROUGH 1978, THE OVERALL INVESTMENT OUTLOOK COULD IMPROVE CONSIDERABLY IN 1979. BARRE HAS ALWAYS SAID THAT HIS PLAN WOULD TAKE ABOUT THREE YEARS TO BEAR FRUIT, AND THIS STILL SEEMS TO BE A GOOD FORECAST.

(C) EXTERNAL SECTOR: IF GLOBAL DEMAND GROWS BY 6 PERCENT IN 1978, ALL PAST CORRELATIONS SHOW FRENCH EXPORTS WOULD GROW BY ABOUT 7 PERCENT. RECENT EXCHANGE RATE CHANGES HAVE BEEN SO FAVORABLE IN TERMS OF FRENCH EC TRADE THAT FRENCH EXPORTS SHOULD ACHIEVE 7 PERCENT PLUS A BIT EVEN IF GLOBAL DEMAND GROWS BY LESS THAN 6 PERCENT IN 1978. FRENCH IMPORTS GREW BY

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ONLY 1 PERCENT IN VOLUME TERMS IN 1977, A PHENOMINALLY LOW RATE WHICH CANNOT BE SUSTAINED, BUT A MODERATE GROWTH RATE THIS YEAR WILL HELP KEEP IMPORTS DOWN.

(D) STOCKS: THE ALWAYS OBSCURE SITUATION OF STOCKS HAS DISAPPEARED FROM SIGHT AS THE RESULT OF ONGOING CHANGES IN THE SYSTEM OF FRENCH NATIONAL INCOME ACCOUNTS. A SURVEY IS UNDERWAY WHICH IS SUPPOSED TO ACTUALLY PRODUCE HARD NUMBERS SHOWING LEVELS OF STOCKS LATER THIS YEAR OR NEXT. MEANWHILE, IT'S BLIND MAN'S BLUFF WITH ANY INFORMED GUESS AS GOOD AS ANY OTHER. THUS, STOCKS CAN ONLY BE TREATED AS A RESIDUAL ITEM IN THE NATIONAL INCOME ACCOUNTS. BASED ON A COLLECTION OF INFORMED GUESSES, WE ESTIMATE THAT STOCKS GENERALLY ARE AT RELATIVELY LOW LEVELS, THAT THEY WILL RISE, PARTICULARLY IN THE CASE OF IMPORTED STOCKS, THROUGH THE THIRD QUARTER OF 1978 AFTER WHICH THEY WILL LEVEL OFF AND BEGIN A SLOW DECLINE AS THE ECONOMY BEGINS TO DIGEST THE NEW LEVEL OF STOCKS IMPLICIT IN A MODEST GROWTH RATE. ON BALANCE, STOCKS WILL BE A POSITIVE ELEMENT IN THE FINAL DEMAND OF THE ECONOMY IN 1978 ENABLING A REAL GROWTH RATE OF ABOUT 3.0 PERCENT RATHER THAN A MARGINALLY LOWER FIGURE.

8. EMPLOYMENT

A 3.0 PERCENT REAL GROWTH RATE IS OBVIOUSLY INSUFFICIENT TO DENT THE UNDERLYING SLOW GROWTH OF UNEMPLOYMENT IN FRANCE. SOCIAL TRANSFER PAYMENTS AND OTHER SPECIAL PROGRAMS DESIGNED TO HELP YOUTH EMPLOYMENT IN 1977 WILL BE CONTINUED THIS YEAR. THE LEVEL OF UNEMPLOYMENT CURRENTLY IS SLIGHTLY OVER 1.1 MILLION, AND A RISE TO THE 1.2 TO 1.3 MILLION LEVEL IS WIDELY EXPECTED. IN

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SOCIAL AND POLITICAL TERMS, UNEMPLOYMENT, OR MORE PRECISELY MEASURES TO INCREASE EMPLOYMENT, ARE LIKELY TO BE THE NUMBER ONE ISSUE IN FRANCE IN 1978, PARTICULARLY IF PRESENT POLICIES ARE PERCEIVED AS PRICE FREEDOM FOR BUSINESS AND WAGE RESTRAINT FOR LABOR. AS IN 1977, THE GOV CAN BE COUNTED ON TO USE PARA-FISCAL MEASURES TO TRY TO KEEP THE UNEMPLOYMENT RATE FROM REACHING POLITICALLY CRITICAL LEVELS.

9. GOVERNMENT POLICY

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IN THE ECONOMIC SHOW AND TELL ASPECTS OF THE ONGOING SUMMIT EXERCISE, THE GOF OFFICIALS HAVE CONSISTENTLY ESTIMATED FRENCH GROWTH RATES WELL ABOVE THEIR OWN INTERNAL FORECASTS--CURRENTLY 3.2 PERCENT-- AND WELL ABOVE THE NEW CONSENSUS FORECAST IN BUSINESS AND FINANCIAL CIRCLES--CURRENTLY BETWEEN 3 AND 3.5 PER-CENT. THE GOF GENUINELY WANTS A COORDINATED GROWTH EFFORT BY OECD COUNTRIES, WISHES THE FRG WERE MORE AWARE OF THE PSYCHOLOGICAL IMPACT OF ITS PERIODIC DOUR PROJECTIONS, AND FOR THESE REASONS REMAINS DETERMINEDLY OPTIMISTIC IN ITS SUMMIT PROJECTIONS. YET FACTS ARE FACTS, AND FROM THE POLICY VIEWPOINT THE FACTS ARE: (A) A FIRM MONETARY POLICY CALLING FOR A 12 PERCENT RISE IN M-2, OR SOMEWHAT TIGHTER THAN LAST YEAR; (B) A FISCAL POLICY THAT IS MORE FLEXIBLE BUT WHICH BECAUSE OF INFLATION WILL SHOW A SIGNIFICANT DECREASE IN THE DEFICIT IN REAL TERMS; AND (C) A RECENT DECLISION TO REDUCE LONG-TERM FOREIGN BORROWING BY FROM 4 TO CONFIDENTIAL

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6 BILLION FRANCS THIS YEAR. OBVIOUSLY, THE GOF WOULDN'T MIND A SPONTANEOUS UPTURN BY THE FRENCH ECONOMY IF IT WERE NOT TOO STRONG. JUST AS OBVIOUSLY THE GOF HAS NOT POSITIONED ITSELF TO INDUCE SUCH AN UPTURN, EXCEPT BY MEASURES TO "LIBERALIZE" THE ECONOMY WHICH COULD ENCOURAGE A POSITIVE RESPONSE BY BUSINESS. EVEN SO, THE PRACTICAL RESULT OF SUCH ENCOURAGEMENT-- I.E., MORE INVESTMENT--COULDN'T POSSIBLY APPEAR UNTIL MUCH LATER THIS YEAR AND MORE LIKELY IN 1979. MEAN WHILE, BARRE PURSUES HIS OVERRIDING OBJECTIVE OF LAYING THE FOUNDATIONS OF A MORE COMPETITIVE AND STABLE FRENCH ECONOMY FOR THE 1980'S. SOMETIMES IT IS VERY DIFFICULT TO DISTINGUISH A PROGRAM OF STRUCTURAL REFORM INITIATED MAINLY THROUGH THE FINANCIAL SYSTEM AND PRICE MECHANISM FROM A PROGRAM OF STABILIZATION. SUCH IS THE CASE IN FRANCE THIS YEAR.

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